REPORT

American Bar Association Central and East European Law Initiative (CEELI)*

Money Laundering: A Concept Paper Prepared for the Government of Bulgaria**

Introduction

Money laundering has become an increasing focus of attention during the last decade. This paper is intended to serve as an introduction for officials of the Government of Bulgaria to issues and policy choices raised by governmental efforts to control and prosecute money laundering. Those issues and choices are relevant to the selection of an approach to money laundering control for Bulgaria and perhaps also in certain respects to the rebuilding of Bulgaria's general systems of fiscal administration, banking regulation, and law enforcement.

We have tried, in drafting this paper, to provide what is in effect a commentary

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to the basic international documents about money laundering. It seemed to us that the best approach was to lay out the considerations that go into money laundering control without trying to make choices for a nation undergoing fundamental change about which we can know only a limited amount.

Even with that objective, we recognize that money laundering is not an easy issue for lawyers of one country to summarize for lawyers in another country. Thus, we have adopted a two-tier approach below. The paper begins with a summary that contains some general observations about underlying legal assumptions reflected in almost any anti-money laundering regime.

The paper then proceeds to six more extensive discussions of portions of the subject. The first proposes a working definition of money laundering, and the second describes the general legal and administrative issues raised by anti-money laundering regimes of various kinds. The paper next turns respectively to an examination of representative enforcement arrangements aimed at money laundering, issues of financial and personal privacy raised by government attempts to track the movement of potentially illicit funds, and certain ''ancillary issues'' that may influence the methods a particular country selects in seeking to deal with money laundering. Finally, the paper discusses in a preliminary way a question that we understand is of particular immediate interest to Bulgarian authorities, namely, the extent to which counter-money laundering enforcement efforts can be applied to combat profiteering and theft during the transformation of the Bulgarian state and economy.

We have at several places identified technical issues without suggesting resolutions for those issues, in line with our view of this paper's appropriate focus. Even in the sections that describe the particulars of money laundering control, we have not made a particular point of the technical differences between various definitions or enforcement arrangements, except where necessary to illuminate the outlines of different approaches. We do not mean to underestimate the difficulty or the ultimate need to resolve technical matters, but we do want simply to place the whole subject in perspective first.

We hope that the approach we have chosen will ultimately stimulate the more detailed inquiries that will be required to put specific money laundering control statutes or regulations into place in Bulgaria.

A Note on Assumptions

The reader of this paper will conclude, we think, that there is a well-defined international consensus on the essentials of money laundering control, but that the attempts of various nations to implement that consensus differ from one another. This should not be surprising, in view of the different legal and regulatory systems onto which money laundering control arrangements must be grafted.

We do think that there are some shared assumptions about general government and legal systems in most of the national arrangements, and in the international documents, that should be understood at the outset. The need for understanding arises not because the assumptions are controversial, but because they may presuppose developments that have not yet taken place fully in Bulgaria.

The first assumption is that property is largely, although not entirely, held in private hands and may be taken by government only after a judicial or administrative determination, based on a stringent set of procedural and substantive safeguards, that laws have been violated or compensation is due to the private property owner.[1] The second is that generally government must refrain from interference in the personal or economic lives of citizens except as strictly authorized by law. The third is that government action, whether directed against property or the liberty of citizens, may be taken only after public hearing and observance of the full set of safeguards sometimes summarized by the phrase "due process of law."

The fourth assumption is that law enforcement within a free society involves responsibilities in several different areas. One is enforcement of criminal statutes, by prosecution, imprisonment, seizure of property, or fine—the so-called police function. The second is enforcement of regulatory or social rules by "civil means," that is fines, court orders that certain actions must be taken or may not be taken, or the withdrawal of regulatory sanction or benefits for activity that does not comply with the rules set by government. We understand that the concept of "civil and regulatory enforcement" (for example, the withdrawal of a bank charter, or the barring of a certain individual from holding a position in a financial institution) may be somewhat difficult to understand at first, but such enforcement is, as the reader will see, a key part of any effective money laundering control system.

Money laundering ultimately entails the use of the lawful commercial system for unlawful means. Controls of the unlawful uses of a lawful system of course presuppose that system is in place and, more, that its assumptions, at least as applied legitimately, are commonly understood and shared by the nation's work force and managers. For example, money laundering control (and tax administration generally) depend upon the ability of government to review the records of commercial operations and to reconstruct transactions; bank supervision depends on much the same capacity. But the maintenance of records is not a novel operation taken to satisfy a governmental objective; record-keeping is essential in a commercial society, and the absence of records is more likely than their presence to indicate unique, and possibly unlawful, circumstances.

For the same reasons, there is likely to be some important relationship between the level of government controls imposed during the period of the transformation of society and the efficiency and speed with which that transformation is accom-

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1. Of course, governments or government-owned enterprises may also "launder" funds or hide assets to accomplish or shield illegal activities, and many of the controls described in this paper must apply equally to government and private transactions. *See* section IV, below, for additional observations on application of money laundering control principles to government activity.

plished. This does not mean that fiscal controls are inconsistent with strong and enduring economic development; the converse may well be true. It also does not mean that a developing society can afford to tolerate lawlessness as a basis for quick economic growth; the experience of a number of nations is clearly to the contrary. But the balance between enforcement and growth and between the costs and benefits of specific approaches to fiscal control need to be carefully calibrated and constantly re-examined.

I. A Working Definition of Money Laundering

Money laundering is fundamentally simple. It involves disguising the existence, amount, provenance, or ownership of funds and other assets in an attempt to avoid (i) detection of illegal activity, (ii) evidence of illegal activity, (iii) taxation, and (iv) restrictions on profitable uses of the proceeds of illegal activity—whether to fund additional illegal activity or to reinvest the proceeds of illegality in legal activity.[2]

At its most basic level, money laundering involves little more than dealing in the proceeds of stolen or illegally derived property rather than in the property itself. Accordingly, government attempts to deal with money laundering must look in two directions at once: at the criminal operators whose activity generates the proceeds, and at the controlled or independent intermediaries that assist those operators in placing, that is, in "laundering," their proceeds and profits.

There appears to be a general agreement, among the major multinational groups that have considered the question, about the core definition of money laundering.[3] That definition has three elements:

- *act*—conversion, transfer, or concealment of the true elements of ownership of property, *or* acquisition or use of property, *or* assisting or counseling such an act;

2. These objectives are of course interrelated; one reason to avoid taxation is to avoid raising questions about the origin or level of the profits being taxed or providing tax investigators with leads that go beyond simple tax avoidance to underlying illegality.

3. The basic documents reflecting the leading international efforts to address the problem of money laundering are (i) the 1988 U.N. Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances, U.N. Docs. E/Conf. 82/15 and E/Conf. 82/14 (December 19, 1988) (the "Vienna Convention"); (ii) the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime, Eur. Consult. Ass., Doc. No. 141 (November 8, 1990) (the "Council of Europe Convention"); (iii) the Report of the Financial Action Task Force on Money Laundering, April 19, 1990 (the "FATF Report"); (iv) the E.C. Directive on prevention of the use of the financial system for the purpose of money laundering, O.J. Eur. Comm. (No. L 166) 77 (1991) (the "EC Directive"); (v) the Model Regulations Concerning Laundering Offenses Connected to Illicit Drug Trafficking and Related Offenses of the Organization of American States, OEA/Ser. P, AG/doc. 2916/92 rev. 1 (May 23, 1992) (the "OAS Model Regulations"); and (vi) the Statement of Principles concerning "Prevention of criminal use of the banking system for the purpose of money laundering" (the "Basle Statement"), adopted by the Basle Committee on Banking Regulations and Supervisory Practices in December 1988. This paper can itself be read as a summary, comparison, and commentary upon the international money laundering regime outlined in those documents.

- *knowledge*—that the property is derived from one or more specified types of underlying criminal activity; and
- *objective*—to conceal the illicit origin of the property or to assist a person involved in the underlying criminal activity in evading the consequences of discovery of the activity.

The FATF Report contains perhaps the most straightforward working definition. It describes "the process of money laundering conduct or behavior" as involving:

- the conversion or transfer of property, knowing that such property is derived from a criminal offense, for the purpose of concealing or disguising the illicit origin of the property or assisting any person who is involved in the commission of such an offense or offenses to evade the legal consequences of his actions;
- the concealment or disguise of the true nature, source, location, disposition, movement, rights with respect to, or ownership of property, knowing that such property is derived from a criminal offense; [and]
- the acquisition, possession, or use of property, knowing at the time of receipt that such property was derived from a criminal offense or from an act of participation in such offense.[4]

The relative uniformity that exists as to the definition of money laundering is reflected in a general agreement on three related points:

1. "Bank secrecy"—*i.e.*, a nation's financial privacy laws—should not be drafted or interpreted as a *per se* bar to implementation of a nation's attempts to deal with money laundering.
2. Any attempt to control money laundering must include a set of rules permitting, and indeed requiring, the forfeiture to the government of funds and other assets found to have been laundered or to have been "derived" from laundering.[5]
3. Money laundering is an international problem that requires states to act in concert both in designing rules to control the movement of illegally-derived

4. FATF Report, Section II(B) (National Programs). *See also* Vienna Convention, Article 3, sections 1(b) and 1(c); Council of Europe Convention, Article 6, section 1; EC Directive, Article 1; and OAS Model Regulations, Article 2, Paragraphs 1 through 4. The FATF Report notes a disagreement as to whether the last of the three elements of the definition is part of the money laundering offense or involves more generally "an economic aspect of crime which must be addressed in any comprehensive scheme against money laundering." The FATF comment reflects the fact that legislative definitions of money laundering have extended the concept beyond what might be termed its historical or popular meaning. *Id.* at n.1. The same issues would naturally arise, in stark relief, if one attempted to apply money laundering concepts to the unlawful diversion of assets from government or previously government-owned enterprises in the course of privatization of the Bulgarian economy.

5. Naturally, individual national forfeiture systems vary with respect to such matters as the burden of proof required to be carried by government authorities to secure such forfeiture, and most systems contain rules protecting the rights of innocent third parties with interests in the subject property.

assets and in conducting or assisting in the conduct of particular investigations.

Two other perspectives are also useful. Law enforcement authorities look at the issue from a functional perspective. Their typology treats the *process* of money laundering as involving essentially three operations (any one or more of which would be criminalized under the more technical definition). The first is the *placement* of criminal proceeds into the legitimate financial system in a way that minimizes notice, attribution, or detection. The second is the *layering* of proceeds in a manner that disguises their origin and true ownership. The third is the *integration* of the proceeds into the channels of legitimate commerce.[6]

A third perspective from which to view money laundering is that of the financial institutions whose use—whether unwitting or otherwise—is essential for the movement of illegal funds. Regulatory attempts to control money laundering, by their very nature, require a balancing of the interests and claims of government authorities with those of the private financial sector and its customers.[7]

Legal and Administrative Issues

The relative uniformity of opinion as to both the general definition of money laundering and the general elements of a money laundering control system is only partially helpful. A great many choices must be made in order to build and administer specific arrangements derived from the definitions.

At least three overlapping sets of issues arise in the creation of any specific money laundering control regime. These involve, respectively, (i) the scope of the money laundering offense, (ii) the responsibilities of the financial community (including the recording and reporting of financial transactions), and (iii) the extent to which enforcement is based on prosecution and the allocation of responsi-

6. The FATF Report emphasizes the importance of such a perspective in creating practical money laundering control arrangements:

> All these techniques [that is whether they make use of smuggling, offshore shell companies, currency transfers, and so on] . . . involve going through stages where detection is possible. Either cash has to be exported over a territorial frontier and then deposited in a foreign financial institution, or it requires the knowing or unknowing complicity of someone at home not connected with the drug trade [or other underlying crime], or it requires convincing a domestic financial institution that a large cash deposit or purchase of a cashier's cheque is legitimate. Once these hurdles have been cleared, the way is much easier inside the legitimate financial system.
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> *Hence, key stages for the detection of money laundering operations are those where cash enters into the domestic financial system, either formally or informally, where it is sent abroad to be integrated into the financial systems of regulatory havens, and where it is repatriated in the form of transfers of legitimate appearance.*

FATF Report, Section I(B) (Methods), final two paragraphs. (Emphasis in original.)

7. Deputy Secretary of the United States Department of the Treasury John E. Robson's statement at the time of issuance of the FATF Report is instructive: "The [FATF] Task Force recognized that money laundering is a complex economic crime that cannot be effectively attacked by conventional law enforcement methods alone. Law enforcement authorities, finance ministries, financial institution regulators, and financial institutions themselves must work as partners to prevent financial institutions from being used by money launderers. . . ." Statement of Hon. John E. Robson, Treasury News, April 19, 1990, at 2. In theory, money laundering is criminal financial intermediation, and its regulation or control is no simpler—is in fact far more complicated—than the regulation or control of legitimate intermediation.

bility as between government and financial institutions—and hence between the police, financial regulators, and private firms and individuals—under particular arrangements.

II. Scope of the Money Laundering Offense

1. Predicate Offenses

The most basic question is the selection of the underlying illegal activities to which money laundering rules apply.[8] The primary candidate, of course, is narcotics trafficking. The Vienna Convention, which Bulgaria has signed and ratified, requires its signatories to adopt measures necessary to criminalize money laundering for assets derived from narcotics trafficking.[9]

The Council of Europe Convention, however, simply calls for steps to establish laundering of proceeds generated from "predicate offenses,"[10] and the OAS Model Regulations take a similar tack, at Article 2 and Article 1, section 4. The EC Directive defines "criminal activity" to include the narcotics offenses in the Vienna Convention, plus "any other criminal activity designated as such for the purposes of [the] Directive by each Member State."[11]

There is increasing agreement that money laundering need not, and should not, be limited to narcotics offenses. There is less agreement on the nature of the other crimes that are appropriate "predicate offenses" under the core definition. The FATF Report suggests several approaches for broadening the definition. The first is to extend the offense "to any other crimes for which there is a link to narcotics." The alternative approaches involve "criminaliz[ing] money laundering based on all serious offenses, and/or on all offenses that generate a significant amount of proceeds, or on certain serious offenses."[12]

Several factors appear relevant to the designation of particular offenses as money laundering predicate offenses. The first is whether the crimes generate significant or untoward sums of cash. The second is whether the crimes are somehow associated with narcotics trafficking. The third is whether the crimes involve serious breaches of international order and require large money transfers—arms trafficking and terrorism come immediately to mind. The fourth is the extent to which the crimes are associated with organized criminal enterprises

8. There is nothing inherently criminal about many of the steps or transactions involved in the process of laundering money, unless those steps are linked to knowledge or an intent to further criminal activity. This proposition is not true, of course, when the steps a money launderer takes include, for example, falsification of import or export documents, perjury in completion of government documents, and bank or tax fraud.

9. *See* Vienna Convention, Article 3, sections 1(a) and (b).

10. *See* Chapter 1, Articles 1(e) and 6.

11. EC Directive, Article 1.

12. FATF Report, Section III(B) (Recommendation 5 and accompanying text).

or activities. The fifth is whether the offenses strike seriously at the credibility of banking and other financial institutions.[13]

Among the nations that have either passed or proposed legislation criminalizing money laundering, these issues have been resolved in various ways. For example, the United Kingdom has made both narcotics trafficking and terrorism predicate offenses for money laundering. In Italy, money laundering is currently a crime only if the predicate offense is aggravated robbery, aggravated extortion, or kidnapping; pending legislation would add narcotics trafficking and organized crime association to Italy's list of predicate offenses. The United States specifies several types of unlawful activity, in addition to narcotics production and trafficking, as predicates for money laundering, including, most importantly, "racketeering,"[14] bribery, counterfeiting, securities fraud, bank and customs fraud, smuggling, espionage, kidnapping, mail and wire fraud, and various environmental crimes.[15]

Although the conversion of large amounts of undocumented currency into bank deposits and other assets is a key component of money laundering, especially in connection with narcotics, money laundering is in no way limited to conduct involving cash. Conversely, many methods of dealing with the cash proceeds of crime have more in common with the most traditional of offenses, smuggling, than with modern money laundering schemes.[16]

Special attention must also be given to the relationship between money laundering and income tax fraud.[17] Money laundering statutes are no substitute, or at best only an imperfect substitute, for tax fraud statutes, even though many of the techniques used by money launderers were developed in part and are still used simply to evade taxes on income derived from lawful activity. A useful point of demarcation, reflected in United States legislation, is thus the nature of the income sought to be hidden. If the income is itself derived from lawful activity (running a factory, selling wheat, painting homes), steps taken to hide or disguise it are generally thought to be matters of tax fraud rather than money laundering;

13. There is a definite, if oblique, relationship between the nature of the offenses designated and the ease or difficulty of proof of knowledge and criminal intent on the part of the money laundering intermediary, as discussed below. Thus, a standard of imputed intent is easier to understand and apply in the case of acceptance for deposit of anomalous amounts of currency than in the case of non-cash transactions involving a superficially legitimate enterprise.

14. "Racketeering activity" is itself independently defined by 18 U.S.C. section 1961 to include acts or threats involving murder, kidnapping, gambling, arson, robbery, bribery, extortion, dealing in obscene matter, dealing in narcotics, and other crimes.

15. *See* 18 U.S.C. section 1956(c)(7) (1992).

16. A money laundering statute need not in any event be the sole basis for criminal prosecutions of conduct involved in money laundering. Thus, while money laundering statutes are not a substitute for tax fraud statutes, the latter may be used against illegitimate as well as legitimately derived income.

17. In this context, "tax fraud" is used simply to denote intentional conduct intended to evade lawful tax payment obligations; whether such conduct technically constitutes fraud depends upon the system of tax administration and the general legal concepts of the country in question.

anti-money laundering regimes tend to concentrate on steps taken to hide or transmute income derived from illegal sources.

The decision to criminalize misuse of the financial system is by no means the sole approach to the problems of fiscal order (or rather disorder) that money laundering reveals. As already noted, an effective approach to money laundering requires cooperation between the public and private sectors, together with a mutual understanding by each of the other's perspectives and problems in dealing with suspect transactions. A crucial question is thus the extent to which reliance is placed on criminalization (and hence individual investigation and prosecution), rather than on administrative supervision and examination, to staunch the flow of illegal funds.[18] There is a continuing tension between the demands of an approach based on punishing conduct and concerns for protecting the integrity and soundness of the financial system of the nation concerned. The question whether a punishment-based approach is the most efficient way to protect a given financial system is a continuing one that is perhaps not capable of a single answer.

2. Problems of Scienter

Even the most limited money laundering statute must address issues of knowledge. The government must prove (or in some systems perhaps the defendant must disprove) knowledge that the property in question is derived from the specified predicate offense. But proof is also required that the investigated transactions concealed the true ownership of the property involved and were carried out to assist in a criminal enterprise.[19]

Concepts of what a common lawyer might call "scienter," or the "knowingness" to be attributed to conduct (and, in the case of proof, to be inferred from that conduct), can be very complex when applied to the paraphernalia of nominee accounts, bearer securities, false names, offshore companies, front organizations, and financial or commercial intermediaries acting at some remove from the immediate criminal conspiracy, that are the staples of complicated money laundering schemes. And it is just at that juncture that problems of proof become the most difficult—whether in a common or civil law system.[20]

Methods of proof are the province of individual legal systems to a great degree,

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18. As discussed in more detail below, this is a crucial area in which the way a nation deals with money laundering both depends upon and reflects the general structure of its legal and financial systems, and, ultimately, of its political economy.

19. A quote from an old legal dictionary makes the point:

> A man may do many acts which are justifiable or not, according as he is ignorant or not ignorant of certain facts. He may pass a counterfeit coin, when he is ignorant of its being counterfeit, and is guilty of no offense; but if he knew the coin to be counterfeit, which is called the *scienter*, he is guilty of passing counterfeit money.

II *Bouvier's Law Dictionary*, Rawle Revision (1914) 3013. (Emphasis in original.)

20. The necessity for judicially acceptable proof of criminal conduct is one of the mainstays of due process and is crucial for both the evenhanded administration of justice and the imposition of severe criminal sanctions. But this fact makes sole reliance on criminalization a less than totally effective method of dealing with the issues of fiscal regulation that money laundering creates.

but there is a developing consensus that the effectiveness of criminalization as a meaningful sanction requires the ability for inferential proof. The Vienna Convention provides that "[k]nowledge, intent or purpose required as an element of [any of its] offence[s] may be inferred from objective factual circumstances,"[21] and the EC Directive adopts virtually identical language in its definition of money laundering.[22] The OAS Model Regulations do the same.[23]

As the interaction between criminal justice and regulatory systems for dealing with money laundering increases, suggestions have been made that the standard for criminal liability be extended. The FATF Report noted that some of the FATF delegates would have expanded the Vienna Convention approach to treat as criminal situations in which a money launderer "should have known the criminal origin of the laundered funds," while "a few countries would impose criminal sanctions for negligent money laundering activities."[24] Some nations have indicated more willingness to use a "willful blindness" standard in connection with narcotics money laundering than in connection with certain purely financial offenses.

Other approaches to problems of proof are also possible. The United States, for example, requires ultimate objective proof that laundered funds were in fact derived from a "specified unlawful activity," but necessitates proof with respect to the launderer's knowledge, only that the launderer knew the funds were derived from *some* unlawful activity.

3. Enterprise Liability

Because most significant financial intermediation is carried on in corporate form in developed countries, attempts to criminalize money laundering raise the corollary issue whether a corporation can or should be criminally or financially liable for acts of its employees, and if so, the standard of imputed liability to be applied. The FATF Report's Recommendation 7 approaches the issue gingerly, by stating that "where possible, corporations themselves—not only their employees—should be subject to criminal liability."[25]

The extent to which enterprise liability can be imposed for money laundering, currency reporting, or export or similar violations normally reflects a national legal system's general rules about the liability of a corporation (or any other enterprise) for the acts of its employees and agents. Such liability derives from general principles about the nature of a corporation, but it is by no means unlim-

21. *See* Article 3, section 3.
22. *See* Article 1.
23. *See* Article 2, Section 5.
24. *See* FATF Report, Section III(B) (Recommendation 6).
25. *See* Section III(B).

ited.[26] Again, the nature of the predicate offense for money laundering becomes a crucial factor. Thus, laundering of the proceeds of narcotics trafficking especially has been recognized as a particularly appropriate case for enterprise liability (making it easier for a corporation to itself be found criminally liable for acts of its employees in moving funds through the corporation's accounts or using the corporation's banking facilities), even if such imposition created a stricter standard of liability in such a case than the degree of enterprise liability that might be applied in cases of other criminal violations.

4. Defenses Based on Other Obligations

While bank secrecy has been rejected as a *per se* defense to money laundering, other obligations may be sought to be interposed against the money laundering prohibition. Consider the situation of a lawyer who advises a client, in advance of a proposed transaction, about cash reporting rules or standards of knowledge required to be proved to establish criminal conduct. Is the lawyer potentially counseling or abetting money laundering? What about an accountant or financial advisor who, in arranging what could be a normal commercial transaction, consciously fails to ask certain questions as part of his work? Must the advisor obtain independent documentation of the source of the funds involved in the transaction? These issues are more than simple questions of proof or liability in nations in which professional obligations—such as the right to effective representation and the duty to protect the confidentiality of attorney-client consultations—are themselves written into law.

The FATF has noted with special concern the problems raised by the role of unscrupulous lawyers:

> [T]hroughout the world there are certain lawyers that specialize in exploiting the secrecy laws of various countries to obscure the identity and the transactions of their clients, often to cover illegal activity, including money laundering. They frequently act as nominees for illegal entities so that the true identity of the beneficial owner can be shielded from law enforcement scrutiny. If illegal activity is detected, these lawyers avail themselves of the double-edged sword of financial institution secrecy and attorney-client privilege to prevent authorities from investigating the client's activities.[27]

26. In Anglo-American corporate law, a corporation is a separate legal person but can only act through its employees or other agents. The converse to the proposition that the act of an agent—say, in signing a contract to deliver goods—binds the corporation is that the corporation can be liable for the harm caused by [an] agent as a result of activities—for example, driving a delivery van—within the scope of his or her employment. In the case of violation of criminal law, however, imputation of liability depends upon whether the corporation itself is sufficiently linked to the criminal activity to support a finding that the corporation possessed the intent to commit a crime.

27. FATF Annual Report, 1991-1992 (June 25, 1992), paragraph 66. The FATF's Working Group I (Legal) goes into still greater detail:

> Money launderers and their clients are increasingly relying on these attorneys to assist them in their criminal ventures. In some instances attorneys are used to establish shell corporations through which monies can be laundered, while in other instances, monies are actually being laundered through attorney-client trust accounts.

III. Responsibilities of the Financial Community

There is common agreement that any attempt to control money laundering must include active assumption of responsibility, within certain limits, by the financial community itself.[28] The agreement is reflected in the Statement of Principles concerning "Prevention of criminal use of the banking system for the purpose of money-laundering" (the "Basle Statement") adopted by the Basle Committee on Banking Regulations and Supervisory Practices in December 1988.[29] The Basle Statement, which is reflected in turn in the FATF Report as well as the EC Directive, emphasizes three sets of responsibilities:

- No system of preventing abuse of banks can hope to function unless banks understand the true identity of the persons with whom they are dealing and the beneficial owners of their deposits;
- Banks should avoid knowingly lending their offices to money laundering; and
- Banks must cooperate actively with law enforcement authorities.[30]

1. Customer Identification

The Basle Statement asks banks to "make reasonable efforts to determine the true identity of all customers[,] . . . institute effective procedures for obtaining identification from new customers[,] . . . [and adopt] an explicit policy that significant business transactions will not be conducted with customers who fail

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> The group agreed that the fact that a person acting as a financial advisor or nominee is an attorney should not in and of itself be sufficient reason for such a person to be able to invoke an attorney-client privilege. Moreover, in order to ensure that false claims of attorney-client privilege are not being used to afford protection to money launderers and/or to obstruct money laundering investigations, competent authorities should examine carefully the validity of any claim by attorneys of such privilege. The attorney-client privilege must be pierced where the privilege has been falsely asserted to shield criminal activities of money launderers.

See Interpretive Note, Final Report of Working Group I (Legal), Financial Action Task Force 3, 1991-92, printed in Annexes to FATF Annual Report, 1991-1992, page 4.

28. *See* Recommendation No. R(80)10, "Measures against the transfer and safeguarding of funds of criminal origin," adopted by the Committee of Ministers of the Council of Europe (June 27, 1980). The financial community for this purpose includes both banks and other types of financial intermediaries, but the most attention has been paid to banks, both because of their historic role and because the general structure of banking makes that industry somewhat more amenable to cohesive action and supervision than less well-defined financial industries. The special problems raised by attempts to apply the principles discussed in this section of the paper to non-bank institutions are discussed in section IV(4), below.

29. The Basle Committee is composed of representatives of the central banks and supervisory authorities of Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Sweden, Switzerland, the United Kingdom, and the United States.

30. The Basle Statement was described by the Committee as "a general statement of ethical principles," and was designed, in the words of the Statement, at Section I:

> to reinforce existing best practices among banks and, specifically, to encourage vigilance against criminal use of the payments system, implementation by banks of effective preventive safeguards, and co-operation with law enforcement agencies.

The Preamble to the Statement explains the Committee's view that "the first and most important safeguard against money-laundering is the integrity of banks' own managements and their vigilant determination to prevent their institutions becoming associated with criminals or being used as a channel for money-laundering."

to provide evidence of their identity," recognizing that failure to obtain such information will thwart an institution's own efforts to prevent use of its facilities for criminal purposes and reduce the effectiveness of any cooperation it offers police authorities.[31] The FATF Report takes the same basic position in its Recommendations 12 and 13, which would (i) proscribe "anonymous accounts or accounts in obviously fictitious names," (ii) require recorded identification of both regular and casual customers on the basis of reliable documents of identity, and (iii) ask financial institutions to "take reasonable measures" to obtain information about the true identity of the person for whom their ostensible customer is acting.[32]

The EC Directive adopts a somewhat more targeted approach, as befits its mandatory character, requiring identification of customers (other than other financial and credit institutions or in the case of certain interbank transactions for customers) with whom an institution enters into "business relations" or casual customers in a transaction (or apparently linked series of transactions) that amounts to at least ECU 15,000, or for which (at whatever amount) "there is suspicion of money laundering." The obligation extends to "reasonable measures" to ascertain the identity of real parties in interest in the case of "doubt" or certainty that the ostensible customers are not acting on their own behalf.[33] Problems of identification obviously become especially knotty in the case of customers acting through attorneys or in the case of transactions of an ostensibly fiduciary nature conducted for unnamed beneficiaries.[34]

2. Good Faith Compliance with Law

The Basle Statement, at Section III, specifically calls for banks not to "set out to offer services or provide active assistance in transactions which they have good reason to suppose are associated with money-laundering activities." The Statement acknowledges the difficulties a bank may have in "knowing whether a transaction stems from . . . criminal activity," and accordingly affirms the importance of communication to and training of bank staff in matters covered by the Statement. The FATF Report's Recommendation 15 suggests that banks must "pay special attention to all complex, unusual, large transactions, and all

31. *See* Section II.

32. *See* FATF Report, Section III(C)(2). Recommendation 13 cites the special need for care in dealing with "institutions, corporations, foundations, trusts, etc., that do not conduct any commercial or manufacturing business or any other form of commercial operation in the country where their registered office is located."

33. *See* EC Directive, Article 3, sections 1, 2 and 5. *See also* OAS Model Regulations, Article 10 (Identification of Clients and Maintenance of Records).

34. For example, the FATF's Working Group II (Financial Matters) has noted problems raised for customer identification principles by so-called omnibus or trust accounts, that is bank accounts holding securities managed by an intermediary (for instance a securities broker, investment manager, or attorney) in which funds of different clients are commingled. *See* Report to the FATF from Working Group II, 1991-92, reprinted at Annexes to FATF Annual Report, 1991-92, at 10.

unusual patterns of transactions, which have no apparent economic or visible lawful purpose."[35]

3. Cooperation with Law Enforcement Authorities

Section IV of the Basle Statement calls for banks to avoid assisting customers who wish to deceive law enforcement authorities "through the provision of altered, incomplete or misleading information." The Statement provides that a bank is to take "appropriate measures, consistent with law" to deny assistance and sever relations with customers if the bank is aware of facts "which lead to the reasonable presumption that money held on deposit is derived from criminal activity" or that requested transactions are "themselves criminal in purpose."

It is at this point that the relationship between public and private activity is clearly joined. The Basle Statement itself recognizes, at Section IV, that cooperation can only occur "to the extent permitted by specific local regulations relating to customer confidentiality." And both the FATF Report and the EC Directive translate the principle of cooperation into steps that depend not simply on private action, but on the legislative and administrative framework for relationships between private institutions and government in this context. The paper now turns to that subject.

IV. Relationship Between Government and Private Institutions

Relationships between government authorities and private institutions created in the attempt to prevent and punish money laundering tend to be distinguished from one another by the extent to which governments require certain kinds of record-keeping, reporting, or both, by financial institutions, and by the consequences of compliance or noncompliance with such rules. But the way the relationships are worked out illustrates the extent to which a government chooses to rely on criminalization and prosecution or administrative regulation to control illicit transactions.[36]

The relationships tend to have three components:

- Mandatory bank record-keeping;
- Reporting to the government of suspicious transactions; and
- Reporting of all transactions of a certain type or above a certain size.

35. *See* Section III(C)(3). The EC Directive states the point a bit more narrowly, requiring financial institutions to "examine with special attention any transaction which they regard as particularly likely, by its nature, to be related to money laundering." *See* EC Directive, Article 5.

36. The emphasis in this portion of the paper on prosecution and regulation does not gainsay the importance, and potential efficacy, of voluntary action by associations of financial institutions or individual institutions to bar access by criminals or their agents to the financial system. The steps noted in the Basle Statement, and the fact of the Basle Statement, are good examples, as are "guidance notes" issued for bankers in the United Kingdom and Switzerland. Some commentators have noted that the risk of public opprobrium or negative publicity may influence bankers to avoid questionable conduct as effectively as threats of government action.

The first two components are more or less standard; the third is somewhat less universally accepted.

1. Mandatory Record-keeping

The effectiveness of money laundering investigations and prosecutions depends upon the ability of authorities to reconstruct financial transactions. That depends, in turn, upon the existence and maintenance of banking and other records from which such transactions can be reconstructed. The Basle Statement's insistence, at Section V, that banks should "implement specific procedures . . . for retaining internal records of transactions" in order to promote the Statement's principles, is the natural corollary to the general agreement about the necessity for limitations on total bank secrecy; a bank that maintains no records or incomplete records is as secret as a bank that maintains perfect records but refuses to reveal them. Either way, the investigator is stymied.

The FATF Report states the general objectives to be sought from private sector record-keeping in this area, calling for the maintenance of:

> all necessary records on transactions, both domestic and international, to enable [banks] to comply swiftly with information requests from the competent authorities. Such records must be sufficient to permit reconstruction of individual transactions (including the amounts and types of currency involved, if any) so as to provide, if necessary, evidence for prosecution of criminal behavior.[37]

The recommendation also extends to account records, business correspondence, and records of customer identification. The required retention period is "at least five years after the account is closed."[38] Article 4 of the EC Directive takes the same approach.[39] The United States, which has a highly developed set of rules for customer accounts, specifies in legislation and regulations, with some degree of precision, the records that banks are required to maintain.[40]

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37. FATF Report, Section III(B)(2) (Recommendation 14).

38. *Id.*

39. The terms of the EC Directive are slightly different, calling for the retention, "in the case of transactions," of "the supporting evidence and records. . . ." It is unclear whether the different formulations would require different record retention in practice.

40. *See generally* 31 C.F.R. Part 103. The U.S. record-keeping provision has essentially two elements: (1) the "know your customer" requirement, and (2) comprehensive record-keeping. Under the former, a financial institution must record the customer's taxpayer identification number and certain other information with respect to each certificate of deposit sold or redeemed, and each deposit or share account opened, within thirty days after the transaction or the opening of the account. Under the latter, each financial institution must retain copies of a number of specified items and documents relating to its accounts. The required copies, which may be stored on microfilm, microfiche, or other retention technique, generally include copies of each check, clean draft, or money order for an amount of more than $100 drawn on the financial institution or issued and payable by it. Even with such a highly developed system, regulators must keep pace with changes in the financial system, and a current issue under debate in the United States is the extent to which the record-keeping regime is to be extended to domestic and international wire-transfer transactions.

The requirement that banks maintain records, whatever its details, is no more than that. The manner and extent to which information from those records is made available to a country's investigators, prosecutors, and regulators depends upon the country's rules as to criminal and investigative procedure and financial privacy, discussed below. But the record-keeping requirement has significant efficacy in and of itself, aside from its function of keeping records available to permit the planning of law enforcement investigations. A record-keeping regime necessarily re-enforces and indeed implements the obligation that a bank "know its customers" and decline to participate in suspect transactions. Such a regime creates a basis for a bank's internal compliance programs. Finally, mandatory transaction record keeping creates a structure for bank examinations in the event that concerns are raised about the relationship between a bank's possible unlawful activities and its safety and soundness.[41]

2. Reporting of Transactions

The most difficult aspect of the relationship between banks or other financial institutions and government in connection with money laundering control involves the degree to which banks are required to report transactions to government authorities. There is general agreement, we believe, that reporting at some level is a key aspect of any system of money laundering control, but its terms and consequences can vary and require careful consideration. The crucial variables are whether reporting by banks is voluntary or mandatory and whether the reporting involves only transactions suspected of involving criminal activity or extends as well to transactions in a given medium, most importantly cash, above a certain threshold. A key factor in determining the usefulness (and to some degree the acceptability of reporting in the financial community) is the capacity (both actual and perceived) and willingness of government authorities to use the information reported.

(a) *Reporting of Suspicious Transactions*

The first level of interest is the reporting by institutions of transactions that they regard as suspicious, that is, as potentially involving attempts at the movement of funds derived from criminal activity. The FATF Report recommends succinctly that:

> If financial institutions suspect that funds stem from a criminal activity, they should be permitted or required to report promptly their suspicions to the competent authorities.[42]

41. This assumes, reasonably, that any financial privacy regime contains an exception for bank examination by regulatory authorities concerned with a bank's soundness and compliance with banking laws. Referrals of the details of specific transactions by bank examiners to criminal investigators may raise separate issues of financial privacy.

42. FATF Report, Section III(B)(3) (Recommendation 16).

The EC Directive calls for member states to:

> ensure that credit and financial institutions and their directors and employees cooperate fully with the authorities responsible for combating money laundering . . . by [in part] informing those authorities, on their own initiative, of any fact which might be an indication of money laundering.[43]

The OAS Model Regulations require reporting to competent authorities of transactions "that . . . could constitute or be related to illicit activities." OAS Model Regulations, Article 13, section 2.[44]

(b) *When to Report*

Any reporting scheme that requires the identification of "suspicious transactions" raises many issues, of which the clearest are what gets reported, when, and how. Asking banks to identify transactions they regard as suspicious reemphasizes the need, recognized by all the commentators and noted above, for comprehensive training of bank employees to recognize suspect transactions or relationships.[45] Similarly, recognition and reporting must be contemporaneous with transactions to do the most good for law enforcement officials.

Finally, any reporting scheme places responsibilities upon authorities that are in some ways as important as the responsibilities placed upon banking officials. Attention must be given to the manner in which reported information will be distributed among government authorities charged with enforcement responsibilities—consistent with the limitations that financial privacy rules place upon use of the information, also discussed below.

(c) *Voluntary and Mandatory Reporting*

The decision whether reporting of suspicious transactions should be voluntary or mandatory is a complex one. The FATF Report notes simply the existence of "a divergence of opinion within the Task Force" on the question, with "[a] few countries strongly believ[ing] that this reporting should be mandatory . . . with administrative sanctions available for failure to report."[46] Of course, in a nation that has criminalized money laundering, even a voluntary system is not

43. EC Directive, Article 6.

44. The reporting requirement is linked to the provision of the Model Regulations that institutions "shall pay special attention to all complex, unusual or large transactions, whether completed or not, and to all unusual patterns of transactions, and to insignificant but periodic transactions, which have no apparent economic or lawful purpose." OAS Model Regulation, Article 13, section 1. As discussed below, the OAS Model Regulations also require mandatory reporting of certain levels of cash transactions.

45. A discussion of bank crime, that is, of such offenses as bank fraud, check kiting, and mail and wire fraud, is outside the scope of this paper. It should be noted, however, that in some nations, including the United States, regulated financial institutions are required to refer to authorities all suspected crimes that may cause loss to the institution, as well as money laundering offenses (which may or may not cause an institution loss, as opposed to assisting in the criminal enterprise of someone else).

46. FATF Report, Section III(C)(3).

wholly voluntary, because a bank's internal compliance programs and the attention it pays to barring the use of its facilities by criminal organizations are likely to affect significantly the outcome of an investigation or prosecution of the bank itself on a money laundering charge.[47]

The efficacy of a mandatory reporting system, on the other hand, depends on the source and enforcement of the requirement that transactions be reported. The strongest argument for mandatory reporting is that a regulatory system is a better mechanism than criminal statutes to deal with certain aspects of the money laundering problem. Provided the authorities are capable of reviewing and analyzing the information reported, mandatory reporting may constitute the most effective source of investigative leads available concerning some types of organized criminal activity. Moreover, a mandatory reporting requirement becomes an element of review in bank examinations and recognizes the link between money laundering and the safety and soundness of the organizations involved.

Whether reporting is voluntary or mandatory, attention must be given to the consequences of reporting in situations in which the reporting bank is not involved in wrongdoing. The consequences that need to be addressed fall generally into two categories: protection for the bank against liability to its customers, and the steps the bank is required to take, once it determines that a transaction is potentially suspicious.

(d) *Protection Against Liability to Customers*

Article 9 of the EC Directive makes clear the importance of protecting banks against claims that their disclosure of potentially suspicious transactions renders them liable for violation of financial privacy or other rules governing bank-customer relationships:[48]

> The disclosure in good faith to the authorities responsible for combating money laundering by an employee or director of a credit or financial institution of information [that may indicate money laundering or that is requested by authorities in response to a report of potentially suspicious transactions] shall not constitute a breach of any

47. No suggestion is intended that authorities would pick out uncooperative institutions for prosecution. Rather, because any institution can act only through its personnel, a charge that the institution itself fostered a climate in which assistance to criminal organizations was either encouraged or knowingly tolerated, rather than simply unknowingly sheltering within its halls a rogue individual who sought to shield his activities both from bank officials and the authorities, is likely to depend upon the steps the bank generally took to prevent its facilities from being so used. Those steps include, most importantly, education and compliance programs, as well as reporting of transactions prior to the challenged event. In other words, the culture of the institution is itself likely to constitute proof of its institutional culpability or innocence in a money laundering prosecution.

48. The substance of the rules that might be violated by referrals of suspicious transactions to law enforcement authorities will depend upon the details of the legal system of the nation involved. In the United States, for example, referrals might violate both federal financial privacy and state privacy and trade statutes, if those statues did not provide exceptions for such referrals. The recently enacted Annunzio-Wylie Anti-Money Laundering Act of 1992 expands and codifies the protection afforded American financial institutions that report suspicious transactions, whether voluntarily or pursuant to regulatory or statutory mandates.

> restriction on disclosure of information imposed by contract or by any legislative, regulatory or administrative provision, and shall not involve the . . . institution, its directors or employees in liability of any kind.[49]

The language of the OAS Model Regulations is in some respects more sweeping.[50] Both provisions reflect Recommendation 16 of the FATF Report, which suggests that, so long as the disclosure of facts relating to a potentially suspicious transaction is made in good faith, the protection of the reporting institution from liability should exist "even if [the institution] did not know precisely what the underlying criminal activity was, and regardless of whether illegal activity actually occurred."[51] The American banking industry maintains that protection from customer liability will increase the willingness and ability of banks to cooperate with law enforcement authorities by eliminating considerable confusion about the consequences of cooperation, and its position is reflected in recent enactment of broad protection from civil liability for institutions that report suspicious transactions.[52]

(e) *Activities Following Reporting of Suspicious Transactions*

Recommendations 17-19 of the FATF Report, Articles 7 and 8 of the EC Directive, and Article 13, section 3, of the OAS Model Regulations address the steps an institution should be required to take following its initial identification and, if required, report of a potentially suspicious transaction. First, the institution and its staff should keep the matter highly confidential and take no steps to alert the bank's customers that they are the objects of suspicion or that a report has been made with respect to their activities.[53] (Obviously, the same issues arise when a bank becomes aware of law enforcement interest because it receives an

49. EC Directive, Article 9.

50. *See* OAS Model Regulations, Article 13, section 4:

> When the report [of transactions that could constitute or be related to illicit activities] is made in good faith, the financial institutions and their employees, staff, directors, owners or other representatives as authorized by law, shall be exempted from criminal, civil and/or administrative liability, as the case may be, for complying with [the reporting rule] or for breach of any restriction on disclosure of information imposed by contract or by any legislative, regulatory or administrative provision, regardless of the result of the communication.

51. FATF Report, Section III(C)(3) (Recommendation 16). The question of liability to customers is different from the question of whether an institution that reports a suspicious transaction that later is found to lead back to employees of the institution may find itself liable for the conduct that it initially reported, or, conversely, whether reporting a transaction in good faith in which the bank later turns out to have been involved, confers some protection against prosecution. The answer to that question is largely fact-based and not capable of a statutory answer. Of course, reporting of such activity should be taken into account in deciding whether to prosecute the institution in the first place.

52. New 31 U.S.C. section 5318(g)(3), added to the U.S. Bank Secrecy Act in late 1992, provides that:

> Any financial institution that makes a disclosure of any possible violation of law or regulation or a disclosure [of a suspicious transaction] . . . , and any director, officer, employee, or agent of such institution, shall not be liable to any person under any law or regulation of the United States or any constitution, law, or regulation of any State or political subdivision thereof, for such disclosure or for any failure to notify the person involved in the transaction or any other person of such disclosure.

53. *See* FATF Report, Section III(C)(3) (Recommendation 17); EC Directive, Article 8; OAS Model Regulation, Article 13, Section 3. The OAS Model Regulations, which would permit notification of "other person[s] authorized by law," is slightly ambiguous in this regard.

inquiry from law enforcement authorities or when it becomes aware, "even in an informal way,"[54] that a customer's account may be the subject of action by authorities.)

The question whether the institution should go ahead with the suspect transaction is even more difficult to answer categorically. Generally, institutions should follow the instructions of authorities, which may include an order not to complete the transaction in countries in which the relationship between law enforcement authorities and financial institutions requires contemporaneous reporting and authorities are empowered to bar transactions.[55] (In some cases, the authorities might either request or order an institution to complete the transaction for the same reason.)[56]

In nations in which no reporting is required, the FATF Report, following the lead of the Basle Statement, recommends that an institution that makes no report "should deny assistance to [the suspect] customer, sever relations with him and close his accounts."[57] Whether a decision so to act is an excuse for failure to make a voluntary report or in fact is counterproductive because of the notice it gives to those who have been identified as potentially suspicious, raises a complex set of legal, administrative, and ethical questions that are beyond the scope of this paper.

3. Mandatory Reporting of Currency Transactions

The second level of interest is a statutory requirement that banks report all transactions above a certain threshold in cash (or other essentially bearer media, such as travelers checks, whose use and conversion to economic value does not generate a paper trail through the financial system). The most commonly discussed requirement is that all transactions in cash above a certain level be reported to Treasury authorities in a manner that requires recordation, verification, and reporting not only of the fact of the transaction, but of the name of the institution through which it passes, the identity of the transacting party, and related information.[58]

Some of the potential benefits of such a system are obvious. While money laundering is not restricted to cash movements, certain targeted transactions, especially the movement of funds from narcotics sales, generate primarily cash

54. *See* FATF Report, Section III(C)(3).

55. Ideally, no action would be taken in any event until the authorities have time to react to the information with which they have been supplied, but the EC Directive recognizes that such delay may both be impossible and in some cases counterproductive, because it would amount to notification to money launderers that their operations had fallen under suspicion, so that ultimately a delay might make apprehension more, rather than less, difficult.

56. *See* EC Directive, Article 7.

57. FATF Report, Section III(C)(3) (Recommendation 19).

58. As a sample of the sorts of information required, see the United States Treasury's Currency Transaction Report (Internal Revenue Service Form 4789, or "CTR").

proceeds. Mandatory reporting provides authorities with a grid of such transactions and creates a level of protection against the failure of institutions, either unwittingly or intentionally, to report potentially suspicious transactions. A currency transaction reporting regime is somewhat easier to enforce than a regime that depends on prosecution for the more serious and complex crime of money laundering; proof that an institution willingly failed to report cash transactions is far easier than proof that it did so knowing that it was dealing with the proceeds of illegal activity in an attempt, or with an intent, to assist in the commission of that activity. Moreover, such a reporting regime, which raises the risks of detection based on the attempt to pass cash through the system, may deter criminal operators from using banks and drive such operators into less effective means of money laundering.

At the same time, a mandatory currency transaction reporting system raises obvious problems. First, such a system depends for its efficacy on the ability of a society to identify a level at which cash transactions become sufficiently inherently suspicious to justify reporting. In the United States, for example, it is relatively rare for individuals to transact business with an institution above the reporting level of $10,000 in cash; such transactions are not unheard of, although they are far from the norm.[59] But some societies are simply more cash-based than others; the more a country's legitimate commerce is conducted in cash the more difficult it becomes to identify a level at which a cash transaction becomes suspicious.[60] (The reporting regimes that do exist provide exemptions for cash transactions by recognized cash intensive businesses, such as grocery stores, that are regular customers of the institution involved. The problems with exemption systems are, again, too technical for this paper.)

Second, reporting schemes will generate a large amount of perfectly innocent information, as well as information indicative of either money laundering, tax evasion, or both. That information must be protected from misuse.

Third, mandatory reporting places difficult cost burdens on the institutions that are required to report, and there is an open debate whether the benefits of receipt of the information by the authorities justifies the cost. While reporting rules are in theory somewhat more simple to enforce than money laundering statutes, enforcement of reporting rules raises its own knotty legal and operational issues, for both prosecutors and bankers, when persons appear to be attempting to evade reporting requirements by passing cash into institutions in a series of

59. The same is generally true of businesses, except for certain cash intensive consumer businesses, such as food stores. Of course, all societies do not rely on credit cards or other cash substitutes to the extent that such substitutes are relied upon in the United States.

60. The FATF Report recognizes this fact when it recommends that "countries should further encourage in general the development of modern and secure techniques of money management, including increased use of checks, payment cards, direct deposit of salary checks, and book entry recording of securities, as a means to encourage the replacement of cash transfers." FATF Report, Section III(C)(5) (Recommendation 25).

related transactions each of which, taken by itself, is just below the reporting thresholds. In addition, there is no area in which the dichotomy between bank regulation and the regulation of other financial intermediaries raises such problems as in the case of cash reporting. The costs of cash reporting by banks are difficult to justify to the extent that similar, more costly enforcement efforts, are not aimed at other financial intermediaries.

The efficacy of reporting depends on the ability and willingness of law enforcement authorities to use the information generated by the reports. In the U.S., for example, the Internal Revenue and Customs Services maintain the information generated by such reports in electronic information systems that are available to investigating agents; the Treasury has created a special agency, the Financial Crimes Enforcement Network ("FinCEN"), a key part of whose mission is the development of advanced computer systems to evaluate, link, and analyze the cash transaction information. Australia, the other major nation to have adopted a cash reporting regime, has created a similar, national, law enforcement organization, the Australian Transaction Reports and Analysis Center, or "AUSTRAC."

In addition, a system for the reporting of cash transactions within national borders must be combined with a requirement of similar reporting of cash movements at a country's border to be maximally effective. The FATF has noted that:

> the phenomenon of cross-border shipments of illegal-source currency, usually directed towards financial institutions in non-FATF countries and non-bank financial institutions both within and outside FATF countries, is on the increase.[61]

The FATF believes that international bank-to-bank transfers, whether within the same multinational institution or between institutions, are worthy of special attention.[62]

Finally, the institution of cash reporting is no substitute for the other steps discussed above. Not all money laundering depends upon cash movements (especially in nations that are transit countries rather than large scale narcotics producers or consumers), and it is simply unclear whether the other serious crimes at which money laundering enforcement efforts are directed depend on cash transactions to such a degree as to justify the costs of reporting.

The FATF Report is worth quoting at some length in this regard because of the summary it provides of the currency reporting issue. The Financial Action Task Force agreed that:

> countries should consider the feasibility and utility of a system where banks and other financial institutions and intermediaries would report all domestic and international currency transactions above a fixed amount, to a national central agency with a computerized data base, available to competent authorities for use in money laundering cases, subject to strict safeguards to ensure proper use of the information.[63]

61. FATF Annual Report, 1991-92, Paragraph 59.
62. *Id.*, at Paragraph 60.
63. FATF Report, Section III(C)(5) (Recommendation 24).

The Recommendation, however, is preceded by a balanced presentation of the problems with a reporting solution:

> [T]he efficiency of such a system . . . is uncertain. The majority of the group was not convinced of the cost effectiveness of this system at this time, and expressed fears that it could lead financial institutions to feel less responsible for the fight against money laundering. On the other hand, it is the view of a few members that a comprehensive program to combat money laundering must include such a currency reporting system together with the reporting of international transportation of currency and currency equivalent instruments.[64]

As indicated above, the members referred to include both the United States and Australia, and U.S. Treasury policy strongly supports the evolution of a workable currency reporting system as part of the international money laundering regime.

4. THE PROBLEM OF NON-BANK FINANCIAL INSTITUTIONS

At several places above, the paper has alluded to the special problems raised for money laundering control by non-bank financial institutions. A number of institutions other than banks, some formal and some informal, can offer persons seeking to place tainted funds with the opportunity to do so, either because of such institutions' links to banks or because of their independent links with financial institutions in other countries. The list includes securities dealers, insurance companies, casinos and other gambling establishments (which traditionally offer a range of financial services to their customers), currency exchange houses, and so-called money transmitters—establishments that wire funds for (usually small or impecunious) customers to other areas. The FATF, which has come increasingly to recognize the centrality of the movement of funds through non-bank institutions to the problem of effective money laundering control, has offered the following useful typology to distinguish types of non-bank institutions:

1—[O]rganizations whose prime function is to provide a form of financial service but which, at least in some FATF member countries, fall outside the scope of the regulated financial sector. For example, bureaux de change, cheque cashers and money transmission services, including those provided through correspondent relationships outside the formal banking sector.

2—Organizations whose primary purpose is to offer some form of gambling activity. For example: casinos, lotteries and various games of chance.

3—Organizations whose primary function is to buy and sell high value items. For example: precious metal and gem dealers, auction houses, real estate agents; automobile, aeroplane and boat dealers.

64. FATF Report, Section III(C)(5). The EC Directive contains no discussion of mandatory cash reporting; the OAS Model Regulations require record-keeping of cash transactions by institutions, and permit, but do not require, "competent authorities" within signatory nations to require reporting to the extent they see fit. *See* OAS Model Regulations, Article 12, Section 7.

4—Professionals who, in the course of providing their professional services, offer, in some countries, client account facilities. For example: lawyers, accountants, notaries and certain travel agents.[65]

Of course, like banks, such institutions serve a variety of legitimate purposes and their growth reflects a market need. But a portion of that market can easily become—and in developed nations is almost certainly—illegitimate.

It is not hard to recognize the non-bank financial institution issue, nor is it difficult to deal superficially with the problem. Thus, the definition of "credit and finance institutions" to which the EC Directive applies includes not only banks, but also, with some idiosyncratic exceptions, investment banks, securities dealers, foreign exchanges, credit card and travel check issuers, leasing contractors, casinos, auction houses, and certain providers of professional services. Both the FATF Report and the EC Directive recognize that their respective principles cannot be effective if applied only to institutions directly involved.[66] The United States requires reporting of cash transactions in excess of $10,000 not only by financial institutions, but also by any other person who receives such funds in the course of a trade or business, including, for example, merchants, providers of services, and professionals.[67]

The real problem is administrative. Whatever problems bank secrecy regimes or particular institutions have posed for law enforcement, banking concerns are generally linked with one another and government by a system of bank examination and regulation that makes uniform action and supervision in connection with money laundering control possible. Securities dealers and insurance companies are regulated, but often not to the same degree as banks, while less traditional forms of intermediation, such as currency exchange houses or money transmitters, may be subject to no effective regulation whatsoever. In this context, it makes sense to rank institutions as "highly-regulated," "less-regulated," and "unregulated," and attempts to impose any regulatory scheme on the latter class of institutions have proved very difficult. As a consequence, unified regulatory or supervisory action against non-bank institutions becomes difficult at best.[68]

Money launderers can also make use in many cases of sellers of large-ticket items such as automobiles, computers, boats, and aircraft, or sellers of marketable items such as metals, art, or even rugs. In the former situation, criminally derived

65. FATF Annual Report, 1990-1991, at page 12.

66. *See* FATF Report, Section III(C)(6) (Recommendation 27); and EC Directive, Article 12.

67. *See* 26 U.S.C. section 6050I (1992). Section 6050I, unlike the general cash transaction reporting rules described above, is a part of the U.S. income tax laws.

68. In the U.S., the situation is further complicated because many non-bank institutions, such as currency exchanges or money transmitters, are generally regulated, if at all, at a state or local, rather than a federal level. The Annunzio-Wylie Anti-Money Laundering Act of 1992 gives the U.S. Secretary of the Treasury authority to issue regulations requiring counter-money laundering programs (and setting minimum standards for such programs) in both bank and, importantly, non-bank financial institutions. *See* Title XV of the Housing and Community Development Act of 1992, Pub. Law 102-550 (October 28, 1992), Section 1517(b).

funds are simply converted to capital assets for use in the operation of a continuing enterprise or for personal consumption. No system of control is likely totally to shut off avenues such as these, and attempts to come to grips with this aspect of the money laundering problem are just beginning.

V. Enforcement Issues

If money laundering control requires a degree of self-examination and concentration by financial institutions, it requires the same degree of administrative reordering by law enforcement officials, both domestically and internationally. The details of such cooperation, like the details of bank compliance systems, are beyond the scope of a concept paper, but several aspects of the required reordering should be noted.

1. Domestic Information Sharing and Cooperation

A nation's enforcement system must emphasize interaction between various enforcement authorities, and among civil administrators, prosecutors, police, and the financial community, to attempt successfully to implement whatever statutory tools government obtains to deal with money laundering. Thus, information exchange and joint investigations between customs, tax, and narcotics officials, often produce the most effective pictures of criminal money laundering organizations. A lead developed or information received in the course of a tax audit may indicate activity that should be the subject of a referral to money laundering investigators, and, conversely, money laundering investigators may uncover complex export fraud or tax schemes.

The placement of primary responsibility for oversight of counter-money laundering programs, analysis of relevant reports of suspicious transactions and currency movement information, and enforcement of laws against money laundering must reflect the statutes a country enacts. A strong argument can be made that the regulatory and investigative aspects of money laundering control should be centered in a nation's Treasury authorities, in a special branch of its police, or in its banking authorities, depending on the facts of a particular country's general organization, but whatever the placement, cooperation between the elements is critical.

2. Forfeiture

A key component of anti-money laundering laws around the world is legislation providing for the forfeiture of assets and goods which are derived from either the underlying predicate offense(s) or the money laundering itself. Although there is ongoing debate about the way asset forfeiture should work, especially about the extent to which forfeiture proceedings should be treated as criminal or civil proceedings, there is widespread agreement that effective control over money laundering is impossible without some type of asset forfeiture program.

Both the Council of Europe Convention and the U.N. Convention specifically direct their signatory nations to adopt asset forfeiture laws. Though limited somewhat by a provision allowing the member nations to declare specific categories of offenses to which it should apply, the Council of Europe Convention includes a very broad confiscation provision. Substituting the definitions themselves in the place of terms defined elsewhere in the Convention, Chapter II, Article 2 of the Convention directs each party to adopt measures at the national level to enable it to confiscate:

> [(i)] any property used or intended to be used, in any manner, wholly or in part, to commit a criminal offense or criminal offenses, [(ii)] any economic advantage from criminal offenses, including property of any description, whether corporeal or incorporeal, movable or immovable, and legal documents or instruments evidencing title to, or interest in such property, or [(iii)] property the value of which corresponds to such proceeds [i.e., "economic advantage . . . "].

Moreover, the Council of Europe Convention further directs the member states to adopt measures necessary to support such an asset forfeiture regime, namely:

> special investigative techniques facilitating the identification and tracing of proceeds and the gathering of evidence related thereto. Such techniques may include monitoring orders, observation, interception of telecommunications, access to computer systems and orders to produce specific documents.[69]

The U.N. Convention also contains comprehensive forfeiture provisions. Under Article 3, which defines offenses and sanctions, each party is directed to legislate sanctions, including fines and confiscation, for the commission of a range of narcotics trafficking and money laundering offenses.[70] Then, under Article 5, the Convention directs its members to adopt measures, consistent with their domestic laws, sufficient to enable (1) confiscation of proceeds derived from and instrumentalities used in narcotics and money laundering offenses; (2) identification, tracing and seizure of such proceeds and instrumentalities; (3) acquisition or seizure of bank records; and (4) cooperation with requests from foreign governments *vis à vis* similar prosecutions or confiscation.[71]

As further evidence of widespread international agreement on the need for asset forfeiture legislation, the preamble of the EC Directive provides that member states "should, within the meaning of their legislation, extend the effects of the Directive to include the proceeds of [criminal] activities, to the extent that they are likely to result in laundering operations. . . ." However, none of the articles in the Directive itself deal with forfeiture.

In the case of a seizure related to a narcotics offense, the government may seize any funds and objects of value, within the jurisdiction of the seizing authority, which are furnished or intended to be furnished in exchange for controlled

69. *See* Council of Europe Convention, Chapter II, Articles 3 and 4.
70. *See* U.N. Convention, Article 3, Section 4(a).
71. *Id.*, Article 5, Sections 1-4.

substances, as well as all objects or funds traceable to or intended to facilitate such exchanges.[72] Thus, in addition to the contents of bank accounts, the government may seize automobiles, airplanes, boats, weapons, buildings, and other property used in "facilitating" the manufacture, importation, distribution, and sale of the narcotics, as well as proceeds from the sale of any such property. It is in this connection that a government's ability to trace the movement of funds (and, thus, the overall efficacy of the anti-money laundering scheme) becomes crucial to its successful implementation of a given asset forfeiture statute. If the criminal is able to disguise the true derivation, ownership, or location of given assets, those assets cannot be traced to the underlying predicate offense, and thus cannot be seized. Accordingly, sufficient reporting and record keeping requirements are an essential, if indirect, component of an effective asset forfeiture mechanism.

Substantively, of course, governments differ as to which types of criminal activity they choose to designate as predicates justifying asset forfeiture and in the extent to which they have refined particular doctrines concerning the tracing of assets to illegal activities. In the United States, the list is virtually identical to the list of crimes which serve as predicates for the money laundering offense (with the notable addition of money laundering itself as a predicate for asset forfeiture).[73]

Perhaps the single most notable, and draconian, feature of currently enacted forfeiture regimes is the extent to which those regimes deem the tainted proceeds, property or instrumentalities to belong to the government *instantaneously* upon the occurrence of the crime.[74] This feature of such legislation is based upon the ancient legal fiction that "it is the property which has committed the wrong."[75] Accordingly, under most forfeiture regimes, the burden of proof regarding the lawful origin of proceeds or property allegedly subject to forfeiture is placed, not on the government, but on the putative owner of the allegedly tainted property.[76]

72. *See, e.g.*, 18 U.S.C. Section 981(a)(1)(B) (1992).

73. *See supra* part II.1.

74. *See, e.g.*, 18 U.S.C. Section 981(f) (1992); 21 U.S.C. Section 811(h) (1992) ("All right, title, and interest in property [seized] . . . shall vest in the United States upon commission of the act giving rise to forfeiture under this section").

75. *Manufactures International, Ltd v. Manufacturers Hanover Trust Co.*, 792 F. Supp. 180, 184 (E.D.N.Y. 1992) (citing *U.S. v. One Mercedes-Benz 380 SEL VIN # WDBCA 33A1BB10331*, 604 F. Supp. 1307, 1312 (S.D.N.Y. 1984)). At least in the jurisprudence of England and the United States, the present day concept of asset forfeiture can be traced to the English law concept of a "deodand," whereby the dagger used to stab a person to death was forfeited to the Crown to be applied to pious uses and distributed in alms—a practice having both legal and religious significance. *See* 2 Sir Frederick Pollock & Frederic W. Maitland, *The History of English Law* 473-74 (2nd ed. 1968); Exodus 21:29 (cited in *Manufactures, supra*, 792 F. Supp. at 180); *Black's Law Dictionary* (6th ed.), p. 436.

76. *See, e.g.*, 19 U.S.C. section 1615; Regulations for Expedited Administrative Forfeiture Procedures, Section 6079 of Pub. L. No. 100-690 [uncodified]; U.N. Convention, Article 5, Section 7 (encouraging member parties to adopt such a reversal of the ordinary burden of proof in asset forfeiture cases). *Cf.* 21 U.S.C. section 881(d) (probable cause constitutes a *prima facie* case for

However, the United States Supreme Court has recently reminded law enforcement authorities that the fictional forfeiture doctrine can be taken too far and should not be used to cut off the rights of innocent third parties having interests in the seized property.[77]

Other procedural features of forfeiture statutes include provisions for the orderly seizure, summary and judicial forfeiture, condemnation and disposition of property and proceeds, remission or mitigation of such forfeitures, and the compromise of claims. Of course, the primary challenge in drafting such provisions is to ensure that the government is evenhanded and accountable in its assertion of rights to and its disposition of seized assets. In the United States, the Supreme Court has recently affirmed the right of third parties to make a claim of rights in seized property arising after the commission of the asserted offense and before the seizure—provided those claimants can prove to have had no knowledge of the property's derivation from illegal activities or the proceeds of such activities—and is currently considering the extent to which a seizure is void if the value of the property seized far exceeds the amount involved in the offense on which the seizure is purportedly based. Finally, of course, the possibility of forfeiture should not in and of itself be perceived to be (and should certainly not be) the primary reason for beginning an investigation or making a seizure. Efficiency in enforcement, and in depriving those involved in criminal activity of the proceeds thereof, must to some extent give way to these more general "due process" concerns.

A particular country's forfeiture rules are likely to reflect the general tenor of its legal system's property concepts and historical experience, but those building blocks generally require statutory codification before they can be efficiently or fairly involved in modern law enforcement situations. Thus, for example, when the United States Congress enacted asset forfeiture legislation in 1986, it simply borrowed rules from the customs laws and from admiralty and maritime law. In addition, U.S. asset forfeiture statutes provide for the conversion of seized assets to cash, and then for subsequent distribution of the proceeds to state, federal, and local law enforcement agencies in amounts based at least in part on the various agencies' respective participation in the investigations leading to the seizures.

3. International Cooperation

Money laundering is in some ways the paradigm international crime. Given the ease and speed with which funds can now be transferred electronically across international borders, international cooperation in the fight against money laun-

the forfeiture of drug proceeds). Section 6079(b) provides, in part, for the administrative return of seized property to a defendant if, *inter alia*, the *owner* establishes both a valid, good faith interest in the seized property and that he or she at no time had any knowledge or reason to believe that the property was being used or would be used in a violation of the law.

77. *See United States v. 92 Buena Vista Avenue*, 61 U.S.L.W. 4189 (Feb. 24, 1993).

dering has become imperative to the efficacy of that fight on any particular national battleground. The dependence of national law enforcement authorities on one another is easily understood, given the multinational nature of modern criminal organizations. But the need for cooperation goes well beyond particular investigations. One nation's money laundering control measures can be effectively minimized or negated by inaction on the part of other nations to which funds can flow. Thus, the FATF recognizes that:

> Geographical zones where money laundering schemes develop, or might develop, are, in some cases, well-known and, in any case, can be characterized by some criteria. Such criteria include the lack of any legal requirement for institutions or professions to maintain records for the identification of their clients or the transactions performed, the absence of a legal permission for law enforcement authorities to have access to these records, and the impossibility for them of communicating these records to law enforcement authorities of other countries.[78]

Coordination includes not only policy but technical adjustments to conform systems of different nations to one another. Differing degrees of criminalization, for example, or different definitions or principles of enterprise liability or scienter, may hinder the operation of mutual legal exchange agreements, even among countries wishing completely to cooperate with one another, and such considerations must be taken into account in drafting national counter-money laundering statutes.

Finally, the multinational nature of modern financial enterprise raises its own problems. Authorities have noted the potential significance in money laundering schemes of intrabank transfers between nations with different laws or transfers from companies to their subsidiaries or affiliates. A particular country needs to be familiar not only with its own rules, but with the rules of other jurisdictions that charter or regulate institutions that operate in that country. We understand that a great many German banks operate within Bulgaria's borders, and we therefore would expect Bulgarian authorities to pay special attention to the rules adopted in Germany.

For all of these reasons several major international and regional initiatives have begun the work toward reaching agreement regarding how best to deal with the problems of money laundering. The Vienna Convention, signed by more than 100 countries, contains comprehensive money laundering and asset forfeiture rules and establishes a basis for placing international controls on money laundering. Signatories to the Convention must make money laundering a criminal and extraditable offense, have pledged to eliminate any legislative barriers (such as bank secrecy laws) to cooperation on investigations, and facilitate the identification, tracing, seizure, and forfeiture of the proceeds of narcotics trafficking and money laundering.

The FATF report encourages countries to enter into a network of bilateral and

78. FATF Annual Report, 1990-1991, at 13.

multilateral agreements using generally shared legal concepts to provide practical measures to implement the widest possible range of mutual assistance, and the FATF has continued to work toward that end.[79] It has at present a five-year term, and has set for itself four ongoing tasks:

- assessment of implementation of the FATF recommendations by member countries;
- coordination and oversight of efforts to encourage nonmembers to adopt and implement the FATF recommendations;
- making further recommendations and evaluations and considering developments in money laundering techniques; and
- facilitating cooperation where appropriate between particular organizations concerned with combatting money laundering and between individual countries.[80]

Recently, as part of its program, the FATF has conducted counter-money laundering programs in both Budapest and Warsaw and has met with representatives of Hungary, Poland, the Czech Republic, and Slovakia.[81]

VI. Financial Privacy

1. Record Keeping and Reporting System

A system of required record keeping and reporting of customer information by financial institutions is a crucial element of most counter-money laundering, and, for that matter, effective tax administration regimes. At the same time, the details of such a system and the manner in which it operates must reflect individual privacy rights at all levels.

Several notions seem paramount. These are:

- The assumption that private records are private, unless the legislature properly has designated certain transactions as inherently suspect to require reporting.

79. The membership of the FATF now includes Australia, Austria, Belgium, Canada, Commission of the European Communities, Denmark, Finland, France, Germany, Greece, Gulf Cooperation Council, Hong Kong, Iceland, Ireland, Italy, Japan, Luxembourg, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, Turkey, United Kingdom, and the United States. In addition, observers include the Customs Cooperation Council, the International Monetary Fund, INTERPOL, and the United Nations International Drug Control Program, the Council of Europe, and the Investment Bank for Recovery and Development (the "World Bank").

80. FATF Annual Report, 1990-91, at 3.

81. In a related development, INTERPOL has also adopted model legislation and a series of resolutions on money laundering. Its model legislation provides, *inter alia*, for the temporary freezing of property prior to the filing of criminal charges; the issuance of restraining orders, injunctions and other orders for the seizure of property allegedly derived from criminal activity; and the forfeiture of property to the government of the country where the property is located, upon a conviction for possession of criminal proceeds. Resolutions adopted by INTERPOL in June 1988, November 1988, and April 1989, urge nations to record large currency transactions and share the data with domestic and foreign law enforcement agencies.

- More detailed access to records requires some judicial process designed to assure that citizens' legitimate privacy interests are considered.
- Records may be used, once obtained, only for the specific law enforcement purpose for which they were obtained and do not become generally available to government for all manner of purposes.
- Records must be retained by financial institutions so that they are available if the demands of due process are satisfied.
- Financial privacy concepts do not apply to the obligation to report criminal or potentially suspicious activity and financial institutions cannot be sanctioned for making such reports in good faith.

2. Guiding Principles

Each nation has struggled to reach an appropriate balance between privacy and enforcement considerations, and it seems clear that the balance can never be struck once for all time. Rather, the balance requires constant examination as ways of doing business, record keeping and retrieval systems, and the methods of fraudulent transfers all evolve.

3. U.S. Experience

The experience of the United States provides one example of a system geared to balance privacy and enforcement considerations. The 1970s saw the enactment in the United States of two comprehensive privacy statutes that build on the fundamental American tradition, reflected in the Fourth Amendment to the Constitution, of protecting citizens against unreasonable searches or seizures without judicial process. The Privacy Act of 1974, 5 U.S.C. section 552a, generally restricts the federal government's use of records identifying individual citizens, even though the information has been lawfully gathered by the government for a particular purpose. Financial privacy legislation was enacted four years after the general Privacy Act, in reaction to an unsuccessful constitutional challenge to the U.S. Currency and Foreign Transactions Reporting Act, popularly called the "Bank Secrecy Act."

The enactment of the Privacy Act in 1974 clearly reflected the concern of the U.S. Congress that the advent of the so-called information age warranted explicit protection of U.S. citizens' privacy interests in records maintained by the government. However, in *U.S. v. Miller*, 425 U.S. 435 (1976), after upholding the constitutionality of the Bank Secrecy Act's record keeping and reporting scheme, the United States Supreme Court held that an individual had no standing under the Constitution to challenge on constitutional grounds a bank's disclosure of his records to the government, because the individual did not have a reasonable expectation of privacy in the contents of records maintained by and for business purposes. The legislative response to *Miller* was the enactment of the Right to Financial Privacy Act, 12 U.S.C. section 3401, *et seq.* ("RFPA"). As the name of the statute implies, this law protects only financial information; this limitation is indicative of the approach to privacy protection on a subject by subject basis in the United States.[82]

The Right to Financial Privacy Act is an expression of congressional intent to provide individuals (not corporations or partnerships of greater than five members) with a legitimate expectation of privacy in financial records maintained by private financial institutions. RFPA does not prohibit the transfer of financial information to the federal government;[83] rather, the statute imposes procedural and notice requirements on the government designed to protect the individual's right to privacy in his financial information.

RFPA provides that the government shall not have access to the financial records of any customer maintained by a financial institution unless the records are obtained with the customer's consent or through specified process. The processes through which such records can be obtained are (i) administrative subpoena, (ii) search warrant, (iii) judicial subpoena, or (iv) formal written request that includes, among other requirements, a certification that the request is relevant to a law enforcement inquiry and that a copy of the request has been mailed to the customer.[84]

In cases in which the government obtains records through process rather than through consent, the customer is entitled to receive notice that his records have been transferred to the government, except in certain legislatively sanctioned cases.[85] If the government believes that investigative or other law enforcement

82. In addition to the Privacy Act and RFPA, other statutes are designed to: (i) restrict the interception of electronic (including telephone) communications (*see* Title I of the Electronic Communications Privacy Act of 1986, Pub. L. No. 99-508, codified at 18 U.S.C. Sections 2510-2521 (1992)); (ii) protect the contents of stored electronic communications (such as the contents of records stored by commercial computer services) (*see* Title II of the Electronic Communications Privacy Act, *supra*, at 18 U.S.C. Sections 2701-2710 (1992)); (iii) limit the effect on personal privacy of governmental data matching (*see* the Computer Matching and Privacy Protection Act of 1988, Pub. L. No. 100-503, codified at 5 U.S.C. Section 552a(o)-(v) (1992)); (iv) restrict private sector employer use of lie detector ("polygraph") tests (*see* the Employee Polygraph Protection Act of 1988, Pub. L. No. 100-347, codified at 29 U.S.C. Sections 2001-2009 (1992)); (v) protect against unauthorized electronic access to bank accounts (*see* the Electronic Fund Transfer Act, Pub. L. No. 90-321, codified at 15 U.S.C. Sections 1693, 1693a-1693r (1992)); (vi) prohibit unauthorized access to computer systems (*see* Title II, Section 2102(a) of the Comprehensive Crime Control Act of 1984, Pub. L. No. 98-473, codified as amended at 18 U.S.C. Section 1030 (1992)); and (vii) protect the privacy of cable television subscribers (*see* the Cable Communications Act of 1984, Pub. L. No. 98-549, codified at 47 U.S.C. Sections 551 *et seq.* (1992)).

83. RFPA does not extend to transfers of information to private entities or, in the federal system that prevails in the U.S., state or local governments.

84. *See* 12 U.S.C. Section 3402 (1992).

85. One overriding exception to the notice requirements relates to records received through grand jury subpoena. Section 3413(i) states that, with some exceptions, the provisions of the Act do not apply to records requested pursuant to a federal grand jury subpoena, meaning that customer notice is not required (in fact, the court may require the financial institution not to notify the customer). However, the leniency of this provision is tempered in part by restrictions on subsequent use of records obtained in this manner. Records obtained via the grand jury generally can be used only to

concerns mandate nondisclosure, the government must petition a court to request a delay of notice and make a showing of the adverse effect arising from premature notice. RFPA also specifies how information, once legitimately obtained, may be used. The overall scheme prohibits uninhibited transfers among various agencies of the central government, while attempting to accommodate law enforcement needs. Thus, records may be transferred between agencies where the transferee agency certifies that the "records are relevant to a legitimate law enforcement inquiry within the jurisdiction of the receiving agency or department."[86]

An agency of the federal government that receives a record covered by the Act is required to account for its use and disclosure. Transfer to a second agency again triggers customer notice requirements in most instances. Records may however be transferred to the Department of Justice or the Department of the Treasury (without notice to the customer) if such records are relevant to the investigation or prosecution of a particular crime.[87]

RFPA does recognize, however, that unrestricted government access to financial information may be appropriate only in certain instances. Thus, to the extent that a financial institution regulatory agency is exercising its supervisory authority with respect to a financial institution under its jurisdiction (for example, where the Treasury's Office of Thrift Supervision is engaging in regulatory action with respect to a savings and loan association), this agency is not bound by the terms of RFPA. This is true also for the Treasury Department in its capacity as administrator and enforcer of the Bank Secrecy Act, the principle reporting and record keeping statute.

VII. Ancillary Considerations

The true novelty of money laundering, whether viewed as a criminal offense or as an economic activity, is the extent to which it integrates, and in so doing confounds, the purposes, instruments, and institutions of both antisocial and highly social activity. Because money laundering involves a criminal use of a nation's financial and trading systems, it is almost impossible to discuss money laundering control in a vacuum. The way a country decides to deal with money laundering both reflects and depends upon the nature of its systems of fiscal regulation and upon certain features of its general legal system. The FATF Recommendations recognize that their implementation will require changes to the legal systems of all nations; but changes in legal principles are only one aspect of the design and implementation of a comprehensive approach to money laundering in the context of a particular nation.

consider whether to issue an indictment and must be destroyed or returned to the financial institution thereafter. Furthermore, not even descriptions of such records may be maintained unless the record has been used in the prosecution of an indicted crime.

86. 12 U.S.C. Section 3412 (1992).

87. *Id.*

1. Tax Administration

The basic system of fiscal interaction between a nation and its citizenry is its tax system or systems, which often set the standard for the sorts of records citizens and businesses are required to keep. Conversely, a key goal of money laundering is to avoid the identification of the ownership or control of assets that tax declarations or examinations can trigger; a related goal is simple avoidance of tax payments.

Tax compliance systems are also relevant. To the extent that financial intermediaries such as banks, insurance companies, and securities dealers are required to report to tax administrators about interest and dividend payments to citizens in aid of the equitable administration of a national tax system, those intermediaries are more likely to have in place internal control systems that can also be used, without additional high marginal costs, to combat money laundering.

2. Banking Regulation

As discussed above, a system that relies only upon prosecutions to enforce strictures against money laundering is likely to be ineffective. But the ability of government, prosecutors, and the financial services industries to cooperate, while maintaining their separate spheres of activity, in combatting money laundering will depend, not surprisingly, on the ways in which such industries are licensed and regulated in other areas.[88] While there may be no one preferred model for such cooperation or for money laundering control systems, a money laundering statute that does not take account of the regulatory terrain in which it must take root is not likely to prove effective. In addition, general regulatory oversight, for example in preventing the acquisition of financial institutions by those with criminal histories or connections, is necessarily linked to more specific counter-money laundering measures.

3. Customs Regulation

Although a great deal of money laundering, especially highly publicized cases, involves complex financial transactions carried out through electronic media, an equally significant portion of the offense involves old-fashioned smuggling—the movement of cash in bulk without declaration across national borders. Thus, any comprehensive attack on money laundering must consider physical as well as notional cross-border transfers.[89]

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88. The EC Directive recognizes the uses of such a system when it requires member states to ensure that bank inspectors disclose to law enforcement authorities information discovered in the course of bank inspections that "could constitute evidence of money laundering." EC Directive, Article 10.

89. For example, the FATF has expressed concern about the extent to which "currency is converted into gems, precious metals, or currency equivalent monetary instruments" to facilitate cross-border transfers of illicitly derived monies. FATF Annual Report, 1991-1992, at Paragraph 59.

4. Currency Control

The ability of a country to serve as an efficient channel for money laundering depends upon the ability of persons holding "launderable" funds to convert those funds freely into and out of the country's currency. Funds derived from illegal activities such as narcotics sales, arms dealing, or financial fraud, must be capable of transfer to other jurisdictions if they are to escape permanently a country's systems of law enforcement and taxation. If the country is used as a way station for movement of funds derived from illegal activities in other countries, the funds must be capable of conversion into and out of the country's currency, and that currency must retain a relatively stable value *vis à vis* the currencies of other nations. (The profit margins involved in illegal activities may of course make the owners of funds derived from those activities relatively indifferent with respect to swings in currency value that would discourage less hardy legitimate investors.)

5. General Regulatory and Business Practices

Much of what is said immediately below concerning a nation's legal system also relates to the evolution of its general business practices. Thus, the sorts of record keeping and reporting rules noted above as part of money laundering enforcement systems presuppose general familiarity with and acceptance of techniques of record keeping, financial statements, and the need for accurate reflection of the results of business activity. Those techniques are essential for efficient management of enterprises of all but the most primitive sort.

6. General Legal System

Money laundering statutes combine prohibitions against knowing participation in the movement or investment of cash derived from illegal activities with rules that potentially hold business enterprises liable for the acts of their employees and agents. A great deal thus depends upon the general rules of the country's legal system involving the degree of knowledge required for criminal liability and the extent to which a master can be deemed liable for the acts of his or her servant. While the general legal system's rules need not control, since money laundering is a relatively new offense, a set of money laundering statutes that does not reflect, even as it advances, the legal system of which it will become a part faces a difficult task.

Finally, money laundering control requires, as separately discussed above, a constant balancing between the needs of a society for fiscal control and the needs of a society for personal privacy. There is no fixed formula for such balancing, but the considerations involved are likely to reflect some of the deepest assumptions of the legal system of the nation involved.[90]

90. The observations of the FATF's Working Group III (International Relations) are apposite:

> Other states, particularly some in Central and Eastern Europe, are developing wholly new financial sectors within industrial economies. These are countries whose basic needs extend beyond assistance in combating money laun-

VIII. Money Laundering and Economic Change in Bulgaria

We understand that Bulgarian Treasury and Central Bank officials are especially concerned about the misappropriation of value from newly privatized enterprises or from enterprises created with state subsidies, during the period of the transformation of the Bulgarian economy. The question naturally arises about the extent to which a counter-money laundering regime will curtail or assist in prosecution of such activity. The question is not surprising, because, as two American journalists who have studied the Russian experience recently noted, "the illegal flow of money out of [that] country testifies to the immaturity of the Russian financial system, which has not only been unable to enforce its own laws on tax collection and currency transactions, but also is inconsistent in its rules."[91] It is difficult to supply a categorical answer to that question, but several factors militate against positive expectations. First, money laundering statutes depend for their operation on the identification of predicate crimes. The crimes can extend to various kinds of fraud, as indicated above, but experience with the use of money laundering statutes to deal with that sort of sophisticated criminal activity is limited. Moreover, to the extent that authorities wish to concentrate on intermediaries—to send a message that an intermediary that assists in the misappropriation of national assets is subject to severe penalties—money laundering statutes will present problems of proof that may be far more difficult than in the case of receipt of large amounts of cash from anonymous and seemingly impecunious customers.

At the same time, however, the instinct that money laundering and misappropriation of value during the conversion of state enterprises to private ownership have something in common is a valid one. Money laundering control ultimately involves the accounting, internal audit, and institutional awareness issues that also arise in the case of other sophisticated financial crimes; overweening bank secrecy laws can prevent enforcement of rules against theft as well as they can prevent enforcement of rules against narcotics trafficking or money laundering. Money laundering statutes need not be the only statutes that require record keeping, specialized reporting, and particularized enforcement regimes, and it does appear that the same sorts of considerations that go into a money laundering control program would have relevance for prevention of financial fraud against

dering, and where FATF activity is likely to form part of a wider operation to develop and safeguard the financial sector. A key problem is how to develop supervisory and regulatory systems against a background of mistrust of state interference of any sort. Furthermore, the convertibility of domestic currencies provides new routes for money laundering, and the opening of borders allows increased flows of cash across borders. So assistance for these countries must cover banking supervision and customs controls to combat illicit activities, as well as basic training and new legislation.

Report of FATF Working Group III, Part II, paragraph 6, printed in Annexes to FATF Annual Report, 1991-1992, at 14.

91. *See* Celestine Bohlen, "Russia is Bleeding Billions in Wealth," *The New York Times*, February 1, 1993, A-1, A-6. The subject is also discussed in a series of three articles titled "The Profits of Chaos," by Michael Dobbs and Steve Coll, that appeared in *The Washington Post*, on January 31, February 1, and February 2, 1993.

government enterprises, as they do in the case of investigations for customs or tax fraud.[92]

Nations whose legal systems are more developed in terms of the application of legal rules to free economies may have other ways, based on long-standing concepts, to deal with financial institutions who assist in fraud—for example criminal conspiracy, organized crime, public corruption, or tax fraud statutes. Legal systems do not develop overnight, and a nation whose legal system lacked the basic concepts necessary to prosecute such fraud or theft directly might be able to transplant the necessary concepts on a temporary basis by enacting a comprehensive money laundering statute, especially to the extent that one sought to create a choke point against transmission of funds out of a country through its financial institutions. However, it is not likely that such a statute would serve in the long run as an efficient or just substitute for the development of organic criminal and civil regulatory measures necessary to deal comprehensively with the problem. And misapplication of such a statute could throw unnecessary impediments in the way of the development of healthy economic institutions in the private sector without producing any counterbalancing gains in law enforcement.[93]

IX. Conclusion

The considerations discussed above are numerous and not always easy to harmonize, either with one another or with the situation of the nation to which they are sought to be applied. We hope that this paper has, as we said at the beginning, adequately presented the considerations sufficiently to permit Bulgarian officials to consider the specific issues they face. In that spirit, we can not do better than to close with another observation of the Financial Action Task Force:

> At present, the central and eastern European region is not one of the most significant centers of money laundering. However, as the economies of these countries become more integrated into the world financial system and their currencies move to convertibility, they will become attractive to money launderers. At the same time, the reform and restructuring of the Eastern European financial sector presents an ideal opportunity for these states to take measures that would help them to protect themselves against money laundering.[94]

We are pleased to have been asked to assist Bulgaria in such efforts.

92. Indeed, in most advanced societies, it is the income tax enforcement laws, not the money laundering laws, that impose a general requirement on the citizenry to maintain books and records adequate to substantiate claims of tax liability or nonliability based on a particular picture of one's assets and their derivation.

93. Thus, Dobbs and Coll comment in *The Washington Post*, that, despite the evidence of rampant corruption and economic dislocation that they identify in Russia, "[A] tough crackdown against 'gray and black' international trading, as it is known in Russia, risks snuffing out the very entrepreneurial ambitions and instincts for profit that are the life's blood of any vital market economy. . . ." Dobbs and Coll, "The Profits of Chaos," in *The Washington Post*, January 31, 1993, at A24. One may appreciate the difficulties implied by the statement without believing that such views are an excuse for canceling any particular investigation or policy.

94. FATF Annual Report, 1991-1992, paragraph 90.